

## **Business in Vancouver – Op Ed Short-term Corporate Thinking Shortchanges Society**

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In a 1998 executive briefing at Stanford University, Gary Hamel, the noted strategist and author, said that if you wanted to create shareholder value, you hired a 60-year old CEO, gave him a boatload of shares, imposed a mandatory retirement age of 62, and got out of the way.

He wisely added that whether the almost inevitable bump in share price created genuine wealth was an open question. I was reminded of this anecdote as I, like so many others, surveyed the wreckage that is ImClone, Tyco, Adelphia, WorldCom, K-Mart, Arthur Andersen, and Enron. While I share many of the concerns about corporate scandals, I am surprised so few saw the meltdown coming. The days when firms were public institutions created to serve the public interest ended long ago.

Over the past 100 years, corporations have acquired limited liability, global mobility, and corporate personhood, to cite just three of their most prominent attributes. This has made it difficult to pierce the corporate veil when bad things happen. The emergence of a global, digital economy has created acute pressure on boards and the managers they govern – competitive positions can be overturned quickly, strategy life cycles are shorter, and today's winners can become tomorrow's road kill. Finally and perhaps most importantly, investors, especially those weaned on the excesses of the 1980s and the "boom" years of the early 1990s, have become impatient. They want instant gratification; they don't want to fall behind those 20-something millionaires they keep reading about. And too many securities analysts have been only too happy to tell them they don't have to wait.

The confluence of these three trends – corporate autonomy, a digital economy, and naively impatient investors – created a monster in the form of pressure to produce short-term results.

The typical response to this phenomenon, at least in North America, has been the hiring of a charismatic or "visionary" CEO. Rakesh Khurana, writing recently in the Globe and Mail, underscored the dangers of this approach:

*Faith in the vision of a charismatic leader is a poor organizing principle for contemporary firms, which increasingly depend on the sharing of intelligence and the dispersal of decision making authority across all levels of the organization.*

I would add that the significant, some might say grotesque, incentives given to CEOs to achieve short-term gains compounds the problem. In 2000, the average CEO made 531 times the average hourly worker's pay. Worse, there are few restrictions on when and how a CEO exercises stock options. Enron CEO Ken Lay exercised \$123 million in stock options prior to the scandal that bankrupted his company, and the CEO and CFO of Tyco cashed out half a billion dollars in shares and stock options as the firm was laying off 11,000 employees.

So, what can turn things around?

There is much talk of improving the checks and balances – tighter controls on the accounting and auditing profession, stiffer penalties for offenders, even CEO disclosure of compensation.

Yes, we need honest, competent accounting; and boards of directors should be independent; and CEOs shouldn't be able to cash in stock options while their companies burn. But these strike me as obvious.

What do these scandals mean for the neoclassical theory of the firm and the assumption of profit maximization that underlies it? And where do (or should) the profits go? If corporate directors are required by law to act "in the best interests of the corporation", does this automatically mean maximizing profits for shareholders? Finally, what time scale should we use in measuring the success of a company, and by extension its board and CEO? Does anyone really believe that the millionaires who walked away from Enron, Tyco, and the rest contributed to a sustainable and healthy society over the long term?

Unless we confront these questions, I fear the changes we'll see in the regulation of the market will do little to restore investor confidence, much less contribute to a more civil society.